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Supreme Court, U.S.
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JOSEPH F. SPANIOL, JR.
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No. 89-1106

IN THE SUPREME COURT
OF THE UNITED STATES

October Term, 1989

TRINOVA CORPORATION,

Petitioner,

v

STATE OF MICHIGAN,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE MICHIGAN SUPREME COURT

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether this Court should review the decision of the Michigan Supreme Court which found that the three-factor apportionment formula was a constitutionally acceptable attribution method for a tax imposed upon a unitary multistate business for the privilege of doing business and measured by modified value added?

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OPINIONS BELOW

The Opinion of the Michigan Supreme Court is reported at 433 Mich 141, 445 NW2d 428 (1989), and is reproduced in Petitioner's Appendix, pp 1a-28a. The Order of the Michigan Supreme Court denying rehearing is reported at 433 Mich 1203 (1989), and is reproduced in Petitioner's Appendix, p 29a. The Opinion of the Michigan Court of Appeals is reported at 166 Mich App 656, 421 NW2d 258 (1988), and is reproduced in Petitioner's Appendix, pp 30a-41a. The Opinion and Order of the Michigan Court of Claims is unreported and reproduced in Petitioner's Appendix, pp 42a-51a.

JURISDICTION

The Michigan Court of Claims issued its Opinion and Order on May 5, 1987. Petitioner filed a timely Claim of Appeal with the Michigan Court of Appeals which issued its decision on February 22, 1988. Timely application for leave to appeal was filed with the Michigan Supreme Court which entered its Opinion and Judgment on August 21, 1989. Petitioner's timely petition for rehearing was denied by the Michigan Supreme Court on October 16, 1989.

Petitioner invokes the jurisdiction of this Court to review the Opinion and Judgement of the Michigan Supreme Court under 28 USC § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Petitioner raises constitutional challenges to the Michigan Single Business Tax Act by invoking the Due Process Clause of the United States Constitution, Amendment XIV, § 1 and the Commerce Clause of the Constitution, Article I, § 8, Clause 3. Relevant and challenged provisions of the Michigan Single Business Tax Act, MCL 208.1 et seq; MSA 7.558(1) et seq, are reprinted in Petitioner's Appendix, pp 59a-62a.

STATEMENT OF CASE

Michigan's single business tax, effective Januuary 1, 1976, replaced seven taxes upon business[1]. It also exempted persons subject to the single business tax from the specific tax imposed on intangible personal property by 1939 PA 301; MCL 205.131 et seq; MSA 7.556(1) et seq.

Corporations engaged in manufacture and sale of products became subject to a single tax for the privilege of doing business. Prior to 1976 they were sub-

[1]The domestic building and loan and savings and loan privilege tax; the foreign building and loan and savings and loan privilege tax; the federal savings and loan privilege tax; the domestic insurance company privilege tax; the financial institution income tax; the corporate income tax and the annual corporation privilege (franchise) tax.

jected to an annual franchise tax measured by their capital and surplus, i.e. their net worth, an income tax measured by federal taxable income with some modifications, and a property tax upon their intangibles, mainly stock portfolios and accounts receivable.

Each of these revenue measures, the net worth franchise tax, the income tax and the intangible property tax contained a three-factor apportionment formula of property, payroll and destination sales. Michigan's portion of a multi-state corporation's net worth, income or intangible property was computed by addition of the Michigan percentages of a taxpayer's property, payroll and sales and dividing the aggregate by 3, the number of factors.

The single business tax which was substituted for these three separate taxes, retains the identical apportionment formula. While theoretically imposed upon value added, it is "a tax upon business activity" and "its intended effect is to impose a tax upon the privilege of conducting business activity within Michigan", (Opinion of Michigan Supreme Court, Petitioner's Appendix, p 10a).

The tax base of a value added tax is computed either by subtraction of the cost of purchases (other than labor and capital items) from gross receipts OR the addition of payments for labor, borrowed capital, other production expenses and profits. The subtraction and addition method of tax base computation is

discussed in a 1984 US Treasury Department report on value-added taxation entitled "Tax Reform for Fairness, Simplicity and Economic Growth--Value-Added Tax:[2]

> "Though value added is equal to the difference between a firm's sales and its purchases, it also is equal to the payments for the labor and capital that generate the value added. Under the addition method, a firm's value-added tax liability is calculated adding together the components of value added, wages, rent, interest, and net profit and then applying the tax rate to tnat sum."

The Michigan Supreme Court likewise notes (Petitioner's Appendix, p 10a):

> "Value added, or business activity, is subject to calculation by two equivalent methods. The first method begins with a taxpayer's gross receipts from which all outside purchases are subtracted. The resi-

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[2]This report was reproduced as CCH Standard Federal Tax Reports No. 56, December 27, 1984.

dual figure represents the value added by the internal operations of the taxpayer. The second method is additive. All internal payments representing factors of production such as wages, rent, interest, together with the taxpayer's profit are totaled and constitute the value added by the taxpayer's efforts. The act employs a modified additive method of value added computation. Mobil Oil Corp v Department of Treasury, 422 Mich 473, 495-497; 373 NW2d 730 (1985)."

For a multistate taxpayer, the tax base of value added reflects the multistate taxpayer's operations both within and without Michigan. To determine the fraction of the total or universal tax base of such taxpayer which should be subject to Michigan tax the standard three-factor apportionment formula is employed. The resulting Michigan tax base is then ultimately used to compute the taxpayer's single business tax liability.

In 1985, the Michigan Court of Appeals handed down Jones & Laughlin Steel Corp v Department of Treasury, 145 Mich App 405, 377 NW2d 387 (1985), lv den 424 Mich 895 (1986) (Petitioner's Appendix, pp 63a-72a). As noted by the Michigan Supreme Court, the Jones & Laughlin Court "ruled that when any element of the taxpayer's business activity as reflected in its tax base is shown to be inaccurately represented" (Petitioner's Appendix, p 15a) the taxpayer is entitled to relief from statutory apportionment.

In Jones & Laughlin, the Michigan Court of Appeals approved a taxpayer-devised hybrid formula which allocated compensation to the geographic jurisdiction of employment and apportioned the

remaining elements of value added. In short, the taxpayer was allowed to compute its Michigan tax base by apportioning, as provided by statute, all elements of its tax base except compensation, and then simply plugging in compensation paid in Michigan.

Scores of multistate taxpayers which employed a majority of their workforce outside the State of Michigan petitioned for a refund of taxes upon the basis of the Jones & Laughlin decision. They sought recomputation of their taxes pursuant to the "Jones & Laughlin formula". Additionally, many taxpayers demanded "geographic accounting" not only for "compensation", but also for the depreciation (and in some cases interest and royalty) expense. Many taxpayers simply

filed single business tax returns upon such basis. The State refused to accept the Jones & Laughlin rationale. As a consequence, over 400 lawsuits are being contested in the Michigan courts.

On February 22, 1988, the Michigan Court of Appeals issued its Opinion in Trinova, (Petitioner's Appendix, pp 38a-41a). The three-judge panel of Trinova rejected the rationale and rule of Jones & Laughlin. Upon appeal, the Michigan Supreme Court affirmed (Petitioner's Appendix, pp 1a-28a).

ARGUMENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Petitioner argues that the Due Process and Commerce Clauses prohibit the employment of the standard three-factor apportionment formula to measure a state's portion of the value added by a multistate enterprise. It bases this argument upon the premise that value-added is not an indivisible alloy created by fusion of factors representing business activities which add to the cost of a product but is instead an aggregate of distinct components.

In essence, Petitioner postulates that Michigan's Single Business Tax Act imposes a series of taxes, upon compensation, depreciation, interest expense, royalty expense, i.e. upon each enu-

merated element of the tax base. Since most of these elements are capable of geographic accounting, are locale-specific, Petitioner insists that the Due Process and Commerce Clauses require that, for tax purposes, they be allocated. Petitioner recognizes, however, that the profit or income component of value added should be apportioned.

Thus, Petitioner concludes that it is constitutionally entitled to compute its single business tax, a value added tax, by a hybrid attribution method, combining geographic accounting (allocation of compensation and depreciation expense) and formulary apportionment of the remaining components of the tax base.

We reject Petitioner's premise. Value added is an indivisible concept, a

seemless whole incapable of precise allocation. It is generated by the totality of activities of a unitary business of manufacture and sale of products. It is not realized until the product is sold. This proposition is true regardless of the methodology of tax base computation.

If value added is computed by subtraction of a firm's purchases from its sales, great difficulty is encountered in an attempt to identify the components, elements or sources of the value added tax base. The addition method eliminates this difficulty by quantifying the different components which are fused into value added.

It remains true, however, that absent a market for its products, a manufacturer such as Trinova cannot generate value

added. It has no positive or negative income which is the starting point in the computation of the single business tax base under the addition method. Without a market for its product, Trinova has no gross receipts from sale, which is the starting point in computing value added pursuant to the subtraction method.

In Bass, Ratcliff & Gretton v State Tax Commission, 266 US 271, 282 (1924), this Court stated:

> "So in the present case we are of the opinion that, as the Company carried on the unitary business of manufacturing and selling ale, in which its profits were earned by a series of transactions, beginning with the manufacture in England and ending in sales in New York and other places, the process of manufacturing resulting in no profits until it ends in sales, the state was justified in attributing to New York a just proportion of the profits earned by the company from such unitary business. In Wallace v Hines, 253 US 66, 69, 64 LEd 782, 786, 40 SupCt Rep 435, it was recognized that

a state in imposing an excise tax upon foreign corporations in respect to doing business within the state, may look to the property of such corporations beyond its borders to 'get the true value of things within it, when they are part of an organic system of wide extent,' giving the local property a value above that which it would otherwise possess, and may therefore take into account property situated elsewhere when it 'can be seen in some plain and fairly intelligible way that it adds to the value of the property and the rights exercised in the state.' This is directly applicable to the carrying on of a unitary business of manufacture and sale partly within and partly without the state."

The foregoing observation is applicable to value added by Petitioner. Trinova carries on a unitary business in which it generates value added by a series of transactions ending in sales in Michigan and elsewhere--and the process of manufacture results in no value added until it ends in sales.

Petitioner recognizes that values generated by unitary enterprise of a multistate business may be apportioned by formula to the states wherein the unitary business is conducted. "The lynchpin of apportionability ... is the unitary-business principle." Mobil Oil Corp v Commissioner of Taxes, 445 US 425, 439 (1980).

"Having determined that a certain set of activities constitute a 'unitary business', a State must then apply a formula apportioning the income of that business within and without the State. Such an apportionment formula must, under both the Due Process and Commerce Clauses, be fair." Container Corporation of America v Franchise Tax Board, 463 US 159, 169 (1983).

This Court continued:

"The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency--that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed. The second and more difficult requirement is what might be called external consistency--the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated."

The Michigan Supreme Court tested the single business tax imposed upon Trinova by the requirements of internal and external consistency. It noted that Trinova did not contest the internal consistency of the Single Business Tax Act's apportionment formula (Petitioner's Appendix, pp 18a, 19a). It concluded that "the averaged ratios of Trinova's payroll, property, and sales 'actually

reflect a reasonable sense of how [its Michigan business activity was] generated,' clearly satisfying the constitutional requirements of internal and external consistency" (Petitioner's Appendix, p 25a).

Petitioner, however, characterizes the single business tax as "a tax on compensation" (Petition, p 19). It argues that compensation, depreciation and other "inputs of added value .... With the exception of profit" (Petition, p 19) must be allocated to their source. Petitioner insists that they "should not be apportioned at all ... because the value added by those components is capable of precise location inside and outside the state" (Petition, p 15).

The plain answer to such assertions is that the single business tax, by

statutory profession and judicial interpretation," is a tax upon business activity" and "its intended effect is to impose a tax upon the privilege of conducting business activity within Michigan" (Petitioner's Appendix, p 10a). It does not levy a tax on compensation, depreciation, any other cost of doing business or upon income. It taxes the privilege of doing business in Michigan measured by that portion of total value added which is fairly attributable to Michigan.

The Michigan Supreme Court found that the single business tax satisfies the four-prong test enunciated by this Court in Complete Auto Transit, Inc. v Brady, 430 US 274, 279 (1977). It found that the tax was applied to an activity with a

substantial nexus with the taxing state, was fairly apportioned, not discriminatory against interstate commerce, and fairly related to the services provided by the state.

Petitioner asserts that (Petition, p 15) "The Michigan SBT as construed by the Michigan Supreme Court fails the second and third prongs of the Complete Auto test". It charges unfair apportionment and discrimination against interstate commerce.

It premises the charge of unconstitutional apportionment upon its insistence that the single business tax is imposed on extraterritorial compensation and depreciation. Thus, Trinova reiterates its disagreement with the legislative declaration and statutory construction of

the Michigan Supreme Court that the tax is imposed upon business activity fairly attributable to Michigan.

Petitioner quests for fission of value added and attribution of its fragments to geographic sources. This quest and its rationale cannot be differentiated from Shell Oil Company's contention, rejected by this Court in Shell Oil Company v Iowa Department of Revenue, 488 US ____, 109 S Ct 278 (1988), that income from outer continental shelf activities must be excluded from the pre-apportioned tax base of Iowa's income tax. Values adhering to or produced by unitary activities of a farflung enterprise cannot be assigned to a geographic, Mobil Oil Corporation v Commissioner of Taxes, supra, or func-

tional source, Exxon Corporation v Wisconsin Department of Revenue, 447 US 207 (1980). In Amerada Hess Corporation v New Jersey Department of the Treasury, 490 US ____, 109 S Ct 1617 (1989), this Court rejected the contention that an expense or cost of a unitary business--in that case the windfall profits tax--can be geographically assigned.

Trinova's insistence that the State of Michigan must geographically assign an integral portion of value added, compensation costs and depreciation expense, to the place where these costs are incurred is directly rejected by Amerada Hess, supra, and indirectly, but with equal force, by Mobil Oil Corporation, supra, Exxon, supra, Shell Oil Company, supra, and Container Corporation, supra. The

pre-apportioned tax base of value-added, in order to be meaningful, must include all of the costs, including compensation and depreciation expense regardless of where it is incurred. This tax base, after apportionment by the three-factor formula, characterized as a benchmark in Container, results in taxation of those activities which are fairly related to the advantages provided to Trinova's business by the State of Michigan.

Petitioner argues that the three-factor formula is a benchmark only for attribution of multistate income; that it does not yield a constitutionally acceptable result when applied to value added by a multistate enterprise. It argues (Petition, pp 22, 23) that the sales factor must be eliminated, leaving a two-factor formula of property and payroll.

Whatever theoretical justification may be offered in support of such formula, it has never been adopted by any jurisdiction to measure the income, net worth or property of a multistate business. As noted previously, the single business tax replaced taxes on corporate income, net worth and intangible properties which were attributed to the state, when they arose from or were connected with unitary activities of a multistate enterprise, by the standard three-factor formula.

In 1980, Trinova marketed nearly $104,000,000 of its products in Michigan. The Single Business Tax Act levied an exaction for Trinova's privilege of doing business in Michigan amounting to $293,528. Trinova's tax liability was

consequently less than 3/10 of 1% of gross receipts from its Michigan sales, imposed by a single exaction which replaced exactions on income, net worth and intangible property. In Moorman Manufacturing Company v Bair, 437 US 267, 280-281 (1978), this Court noted that "Appellant's actual income tax was the rough equivalent of a 1% tax on the entire gross receipts from its Iowa sales."

Nothing can obscure the fact that elimination of compensation and depreciation expenses from the pre-apportioned tax base of Trinova and its geographic allocation yields no tax whatever, but results in a negative tax base which can be carried over to other tax years. Trinova's computation of its tax base for

1980 results in a loss carry-over of nearly $28,000,000 computed as follows:

business income (loss)	$(42,466,114)
~~add: compensation~~	~~226,356,271~~
~~depreciation~~	~~23,262,909~~
dividends, interest, royalties paid	22,908,950
other	549,526
subtotal	~~230,611,542~~ (19,007,638)
deduct: dividends, interest, and royalties received	9,486,223
~~Section 9 tax base~~	~~$221,125,319~~ (28,493,861)
Plus:	
Allocated Michigan compensation	511,774
Allocated Michigan depreciation	2,152
Trinova-computed tax base	(27,979,935)

Trinova's assertion that the three-factor apportionment formula amounts to economic protectionism and discriminates against

out-of-state business deserves but scant discussion. It is erroneously premised on the geographic attribution of compensation and depreciation expenses. Such faulty premise leads to the erroneous conclusion that the Single Business Tax Act does not tax compensation and depreciation where the workforce is employed, thus favoring Michigan employers.

The conclusion falls with its premise. The single business tax does not tax compensation and depreciation. For the privilege of doing Michigan business, it levies a tax upon modified value-added, an indivisible alloy created by fusion of profits and all the factors which add to the cost of a product. It is not realized at any particular stage of production or distribution, but is

produced by a series of unitary activities which terminates with the sale of products.

Petitioner complains of "the State's unthinking adoption of the three-part formula used to apportion income taxes." (Petition, p 21) We hasten to suggest that the three-factor apportionment formula was deliberately chosen as a measure of value added by unitary activities of a multistate business. It must be appreciated that the single business tax replaced taxes on income, net worth and intangible property, which were apportioned by identical formula. More importantly, the three-factor formula is used by a majority of states to apportion taxes imposed on multistate businesses.

In the context of general use of such three-factor approach to tax corporate

presence and activities measured by income or net worth, Michigan's single tax on multistate business, if measured by other than the three-factor formula, would ordinarily result in multiple (or partial) tax burdens for a multistate business. General Motors Corporation v District of Columbia, 380 US 553, 559 (1965).

In this case, Petitioner challenges the employment of the standard three-factor formula to value added by the unitary activities of a multistate business. This case does not involve tax credits and tax exemptions which favor local business.

Westinghouse Electric Corporation v Tully, 466 US 388 (1984), involved a credit for exports shipped from the

state; Tyler Pipe Industries, Inc. v Washington State Department of Revenue, 483 US 232 (1987), involved a tax credit for local manufacturers; Boston Stock Exchange v State Tax Commission, 429 US 318 (1977), dealt with a 50% tax reduction for sale and transfer of stock within the state; Maryland v Louisiana, 451 US 725 (1981), invalidated a natural gas tax from which in-state users were partially exempt; in American Trucking Associations, Inc. v Scheiner, 483 US 266 (1987), a commercial advantage was given to local truckers by imposition of a flat rate axle tax.

Scheiner deals with an unapportioned tax burdening interstate commerce; the other cited cases reflect geographical bias, detrimental to non-domiciliary

business, of tax exceptions and credits. These cases relied upon by Petitioner bear no resemblance and are inapposite to this case.

CONCLUSION

In Moorman Manufacturing, supra, this Court declined to interpret the Constitution to require the application of the equally weighted three-factor apportionment formula. In Container Corporation, supra, the Court referred to that formula as "something of a benchmark". Yet, Trinova asks this Court to invalidate the application of the three-factor formula to apportion value added by the unitary activities of a multistate business which is used as a measure of its privilege of doing business in Michigan.

Trinova asserts that it is entitled to geographic sourcing of elements which are fused into value added. This Court has consistently held that sourcing of

income or values arising from unitary activities is not constitutionally required, Mobil Oil Corporation, supra, Exxon Corporation, supra, Shell Oil Company, supra, Amerada Hess, supra.

Alternatively, Trinova insists that its privilege of doing business in Michigan must be measured by a two-factor apportionment formula consisting of property and payroll applied to the total value added to its products. Moorman Manufacturing, supra, dispositively holds that the Constitution does not require the use of any particular apportionment formula.

The three-factor apportionment formula of the single business tax does not discriminate against out-state businesses. It treats both local and foreign

concerns with an even hand. Trinova's "discrimination" claim vanishes with its underlying premise that the Constitution requires the "sourcing" of elements which, by unitary multistate activities, are fused into value added.

For these reasons Respondent requests that the Petition for Writ of Certiorari be denied.

Respectfully submitted,

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